

**Review of Internal Controls over Fixed Assets**  
**Report No. 00-01, October 5, 1999**

**Executive Summary**

Our review determined that internal control over fixed assets is neither efficient nor effective.

Although controls have been designed and placed into operation, they are not effective because they do not ensure the accuracy and usefulness of the agency's master accountable property record. In addition, the present combination of systems and procedures is inefficient and fosters delays and inaccuracies.

**Fixed Asset Accounting and Internal Control**

The RRB has not adequately communicated its purpose in maintaining an accountable property record. As a result, procedures that are intended to maintain the integrity of the agency's master accountable property record have become an exercise in record maintenance.

The Bureau of Supply and Service (BSS) bears primary responsibility for the accuracy of the accountable property record. However, BSS must rely on the reports of each of the RRB's organizational units for accurate information concerning the status and location of assets. BSS has no means of compelling timely reporting.

The large number of low-value items in the master accountable property record make prompt completion of the annual asset inventory and related control procedures very difficult. In addition, lack of precise asset location codes further impedes implementation of these controls.

As a result of delays in the inventory and reconciliation process, the master accountable property record is not accurate. In addition, the current system of internal control does not provide for the recording of assets that have been received but not yet placed into service.

We have recommended that the BSS develop and implement a new, comprehensive system of fixed asset accounting and internal control. A new system should establish specific internal control objectives to be fulfilled by the master accountable property record and distribute responsibility for record maintenance throughout the agency.

**Physical Security**

During our review, we observed that BSS does not store all new equipment in a restricted-access location pending distribution to end-users. We have recommended that such a location be provided for future acquisitions.

## **Financial Statement Audit Issues**

Our review included an assessment of the impact of the current audit findings on the agency's financial statement reporting.

The RRB is not an asset intensive agency. The potential monetary impact of the weakness in internal control over fixed assets is very low relative to the financial statements when taken as a whole. Accordingly, we have concluded that, although a control weakness exists, it does not adversely impact the reliability of financial or performance reporting.

We also reviewed the status of agency actions to correct conditions identified by independent public accountants and the OIG during audits of the agency's 1995 and 1997 financial statements.

Financial statement audits include only a limited scope review of internal control over fixed assets. Based on our full scope review, we believe that the conditions previously identified during the financial statement audits were merely symptoms of an inefficient and ineffective process.

The recommendations contained in this report address the RRB's entire system of internal control over fixed assets. The Bureau of Supply and Service plans to take the recommended corrective action. Accordingly, the outstanding prior audit recommendations will be replaced by the comprehensive recommendation of the current audit.

The full text of management's response is presented in Appendix III to this report.

## **Introduction**

The purpose of this report is to present the results of the Office of Inspector General's (OIG) review of internal control over fixed assets.

## **Background**

The Railroad Retirement Board (RRB) is a federal agency in the executive branch of government. The RRB is funded by annual appropriations voted by Congress that permit the agency to incur obligations and to make payments out of the Treasury for specified purposes. The Bureau of Supply and Service (BSS) creates and maintains records supporting the purchase, deployment and disposition of assets.

Administrative Circular BSS-2, issued April 1, 1998, describes the policies and procedures governing the tracking, maintenance and disposal of the RRB's accountable property. Management's intent in issuing this circular is to "assure that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with generally accepted government accounting principles and

standards prescribed by the U.S. General Accounting Office and the Department of the Treasury.”

BSS uses the fixed assets (FA) subsystem of the Federal Financial System (FFS), a mainframe computer application, to maintain the RRB’s master accountable property record. An accountable property officer (APO) in each of the agency’s major organizational units is responsible for advising BSS of changes to the location or status of assets.

As of April 1999, the FA subsystem listed 7,697 individual assets with a collective original cost of \$38.7 million. Approximately five percent of these assets have been designated as “capital” assets for financial statement reporting purposes. The RRB fiscal year (FY) 1998 financial statements reported \$7.3 million in capital assets valued at historical cost, minus depreciation.

The RRB’s strategic plan states that “we will ensure efficient operations through effective management control and quality assurance programs” as the agency’s second strategic objective in meeting its overall goal of prudent stewardship. This audit speaks directly to that objective.

Prior audits have cited management for non-compliance with agency procedures that require an annual reconciliation of the agency’s accountable property record and a physical verification of assets. Also noted were inadequacies in the controls over the recording of asset dispositions. (The full text of the prior recommendations is included as Appendix I to this report.) The FY 1998 financial statement audit found no improvement in the previously cited conditions.

### **Objective, Scope and Methodology**

The objective of this review was to assess the effectiveness and efficiency of internal control over fixed assets. In order to achieve this objective we:

- obtained and analyzed data from the FA subsystem as of April 8, 1999;
- reviewed the files supporting selected procurements;
- interviewed personnel in the Office of Programs and the Office of Administration;
- conducted a physical inspection of the headquarters building and selected items of equipment;
- reviewed internal control risk assessment documents; and
- identified and tested selected internal controls.

The work was performed in accordance with generally accepted government auditing

standards as applicable to the objectives. Fieldwork was conducted on-site at RRB Headquarters during April through August 1999.

## **Findings and Recommendations**

Our review determined that internal control over fixed assets is neither efficient nor effective.

Although controls have been designed and placed into operation, they are not effective because they do not ensure the accuracy and usefulness of the agency's master accountable property record. In addition, the present combination of systems and procedures is inefficient and fosters delays and inaccuracies. We also observed conditions related to the physical security of agency property that management should address.

The RRB is not an asset intensive agency. The potential monetary impact of the existing internal control weakness is very low relative to the financial statements when taken as a whole. Accordingly, the existing internal control weakness is not a reportable condition for financial statement audit purposes.

Following is a detailed discussion of our findings and recommendations for corrective action.

### **Fixed Asset Accounting and Internal Control**

BSS is currently responsible for the recording, maintenance and disposal of all accountable property, including fixed assets. BSS is also responsible for maintaining the FA subsystem that has been used to track the agency's accountable property since 1990.

Administrative Circular BSS-2 places responsibility for maintenance of accurate and complete property records and completion of required inventories with the RRB's various organizational units. In order to maintain the agency's central property record, the designated APO in each organizational unit must advise BSS, via standard form, of changes in the status or location of assets. BSS records the changes to the FA subsystem.

### **Control Objectives Focus on Record Maintenance**

In connection with the agency's management control initiative, each functional area that is subject to an internal control assessment prepares a chart of controls. The chart of controls identifies risk, establishes control objectives and sets forth the control techniques that have been designed to reduce or eliminate risk.

Accountable property management is the functional responsibility of BSS. The related chart of controls states that one of their internal control objectives is to ensure that "all

accountable property/equipment is only entered once onto the Fixed Assets subsystem, timely and accurately.” This objective focuses on accurate record keeping without providing a convincing motivation for keeping the record.

Typically, maintenance of a central property record is an internal control designed to support financial accounting requirements and provide management with information about the use and disposition of assets. Related controls designed to ensure the integrity of the record, such as periodic inventory procedures, may also be intended to deter theft and misuse.

The RRB has not adequately communicated its purpose in maintaining an accountable property record in a formal control objective. As a result, procedures that are intended to maintain the integrity of the accountable property record have become an exercise in mere record maintenance.

### **Monetary Threshold for Accountable Property**

Administrative Circular BSS-2 requires that any asset with an original purchase price of \$500 or more be recorded in the FA subsystem. In addition, items of lesser value may be recorded if deemed “sensitive.” The circular defines sensitive items as easily portable, of value to the agency and difficult to identify as government property in the absence of a property record.

As of April 1999, the FA subsystem contained entries for 7,697 assets. Approximately 34% of the assets recorded were originally valued under \$500; over 60% were purchased for less than \$1,000. The record also includes some relatively inexpensive items, such as calculators, that cost under \$50.

Once the decision to include an asset in the FA subsystem has been made, the asset must be recorded and its location monitored until such time as it is sold, destroyed, or otherwise disposed of. Once recorded, each asset, regardless of its value, is subject to the inventory and reconciliation process designed to ensure the accuracy of the central record. The large number of low-value items has a negative impact on that process because they inflate the amount of time and manpower required to perform the work.

Although assets originally recorded at individual historical costs under \$1,000 account for 60% of all assets, they represent only 6% of the total cost of all assets recorded. The majority of the agency’s investment in accountable property, approximately 79%, is in the 388 items designated as capital assets: equipment, computer software and hardware, systems furniture and leasehold improvements valued individually at \$5,000 or more. (This refers to the large scale conversion of conventional office space into partitioned cubicles with built-in work surfaces and storage units.)

The threshold for recording an organization’s assets is management’s responsibility and should be established at a level consistent with their objective in maintaining an

accountable property record. In the absence of a clear, overall objective, we cannot evaluate the recording threshold.

### **Inventory and Reconciliation Not Effective**

Administrative Circular BSS-2 calls for each Accountable Property Officer (APO) to perform an annual inventory within his/her organizational unit with the aid of a printed listing provided by BSS. The APO is required to return a signed certification to BSS along with any corrections, additions or deletions required to correct the accountable property record. BSS verifies reported changes as necessary and updates the FA subsystem based on the certifications of the APOs.

The inventory and reconciliation process is a control intended to ensure the accuracy of the property record. It is a back-end control over the accuracy and timeliness of actions to establish new asset records and update existing records. Such actions are accomplished by paper transmittal of information to BSS; only BSS personnel can update the FA subsystem.

The inventory process is not completed timely. Delays in the inventory process cause delays in the reconciliation of the accountable property record. The FY 1998 inventory was initiated by BSS in May of that year and had not yet been completed as of August 1999, a period of 15 months.

Although some inventory reports were received promptly, the most significant reports were substantially delayed. The Office of Programs, which has the largest number of assets in its custody (over 3,000 items), required nine months to respond. The reported corrections were so voluminous that BSS has not verified them all and has not updated the FA subsystem for all of the changes. Efforts to perform the required inventory are impeded by asset location identifiers that are inadequate for use in physically locating equipment. A more detailed discussion of this issue is presented on page .

As a result of delays in the inventory and reconciliation process, the master accountable property record is not accurate. The information contained therein is typically out-of-date and cannot be used to provide management with information for use in planning acquisitions or deploying assets. Further, maintenance of such a record can have little deterrent effect on theft because the reconciliation and inventory process will not identify losses promptly.

When inventory reports are not submitted timely, the tardy unit is not adversely impacted and BSS has no means of hastening the process.

### **Physical Verification of Assets Not Performed**

Administrative Circular BSS-2 requires an independent physical verification review of fixed assets on a cycle basis. The administrative circular has established annual and biennial

verification cycles for various categories of assets. The physical verification review takes place after the inventory and reconciliation process is completed.

BSS has not performed the required physical verification reviews since 1994 largely because of delays in the reconciliation and inventory process. (BSS completed the property record reconciliation for laptop computers in December 1998 but has not yet completed the planned physical verification process.

### **Current Location Codes Are Inadequate**

The present system of asset identifiers is insufficient to permit direct inspection of equipment based on the FA subsystem entry alone.

BSS currently maintains data fields in the FA subsystem containing organization and location codes for each asset. These location codes are very general. For example, the Office of Programs currently has over 3,000 entries in the FA subsystem attributable to only 43 different locations. The FA subsystem lists over 400 assets as located in the Bureau of Fiscal Operations with no more precise information.

The extremely general location codes contribute to redundancy in record keeping and hinder efforts to comply with requirements for inventory, reconciliation and physical verification of assets. Some organizational units maintain separate inventory records with more specific location information in order to facilitate the annual inventory and reconciliation process.

We judgmentally selected assets and attempted to locate them using the information provided in the FA subsystem. Due to the very general nature of the information available, we asked for the assistance of management and staff in locating the selected items. It was impossible to find the selected equipment using only the organization and location codes available on the FA subsystem. Even when an organization maintained its own detailed inventory, auditors could not locate some items.

The lack of precise asset locations severely limits the value of the FA subsystem records. It also hampers efforts to perform the required annual asset inventory and the related record reconciliation. This problem is discussed in detail under the previous Inventory and Reconciliation Not Effective Section.

### **Delays in Recording Acquisitions**

The current system of internal control does not adequately provide for the recording of assets that have been received but not yet placed into service.

BSS does not record new acquisitions until the equipment is delivered to the end-user and placed into service. When equipment is purchased in large quantities, as is frequently the case near fiscal year-end, the agency's ability to process new equipment can be strained.

As a result, long delays between asset receipt and asset recording occur.

The OIG has previously advised management of delays related to the purchase of equipment at fiscal year-end. An OIG management information report, "Problems Related to Fixed Asset Management" (Audit Report No. 98-12), cited long delays between receipt of new equipment, the setup of that equipment and the recording of the acquisition in the FA subsystem. We observed the same conditions during the present review.

During this review, we observed large quantities of computer equipment held in various unsecured locations at headquarters pending distribution to RRB field offices. This equipment was being staged at headquarters as part of a large scale effort to upgrade agency communications with the field service. Several hundred computers were purchased for this initiative.

Excessive delays in recording acquisitions reduce the value of maintaining the accountable property record.

### **Redundancy**

Some organizational units maintain their own property records.

The Office of Programs, responsible for the largest number of agency assets, has initiated development of its own property record in order to facilitate the annual inventory and reconciliation process. The current system of location codes currently available on the FA subsystem was not adequate to meet their needs.

The Bureau of Information Services (BIS) maintains a separate record for acquisitions of computer equipment. The FA subsystem does not support all of the detail needed by BIS, such as warranty periods and service records. In addition, BIS' record is sometimes used as a control to assist in locating specific equipment when the FA subsystem record is questioned or inadequate.

### **Financial Accounting Issues**

The FA subsystem, although technically part of the automated accounting system used by the agency, has not been integrated with the other components of that system.

The RRB capitalizes and depreciates assets and leasehold improvements originally valued at \$5,000 or more. The FA subsystem currently includes approximately 400 assets that meet the criteria for financial statement reporting.

Equipment purchases processed through the FFS are not posted automatically to the FA subsystem. In addition, the FA subsystem does not directly support the financial statement preparation process. The Bureau of Fiscal Operations relies on a combination of manual processes and desktop computer applications to identify and summarize information



related to fixed asset transactions needed for financial statement preparation.

### **Recommendation No. 1**

We recommend that BSS develop and implement a new, comprehensive system of fixed asset accounting and internal control that:

- establishes specific internal control objectives to be fulfilled by the master accountable property record;
- includes control procedures designed to meet the established internal control objective;
- establishes a monetary threshold for the recording of fixed assets that is consistent with the objective in maintaining the record;
- distributes responsibility for record maintenance throughout the agency;
- centralizes responsibility for oversight and control in BSS;
- provides for the control of assets that have been received but not placed in service;
- minimizes paper-based transactions;
- supports the agency's financial reporting requirements; and
- eliminates redundancy.

This recommendation is not intended to dictate implementation of any specific control. We designed this recommendation to encourage implementation of a system of fixed asset accounting and control that will achieve management's objectives. The above list describes some of the qualities that we expect to find in a successful system; it is not intended to be all inclusive.

### **Management's Response**

The Bureau of Supply and Service agrees with the finding and recommendation and will work with the RRB's Executive Committee to design and implement a new fixed asset system.

The full text of management's response is presented in Appendix III to this report.

### **PHYSICAL SECURITY**

Our audit of internal control over fixed asset management included tests of physical security. We interviewed security personnel, observed personnel in the performance of

their duties, and conducted tests of physical security. We inspected each floor of the headquarters building and noted where equipment was being stored.

As previously discussed, the RRB held large quantities of computer equipment in unsecured areas of the headquarters building during FY 1999. Personal computers, monitors, printers and accessories were stored in vacant floor space, offices and hallways on several floors of the building.

As a test of physical security, a new member of the audit staff, unknown to most agency personnel, made a late evening walk-through of one such storage area. During his inspection of these sites, agency personnel working with the equipment in these areas appropriately questioned his presence and activities. The alertness of agency personnel to suspicious behavior plays an important part in safeguarding assets from loss and should be encouraged.

Our review was not sufficient in scope to permit us to express an opinion on the overall adequacy of physical security at RRB headquarters. However, the storage of computer equipment, regardless of quantities, in open access areas is a weakness in internal control.

### **Recommendation No. 2**

We recommend that BSS provide for storage of all new equipment in a restricted-access location pending distribution to the end-users.

### **Management's Response**

The Bureau of Supply and Service agrees with the finding and recommendation. While they agree that newly purchased equipment should be secured, they have also noted that availability of space is an important issue, particularly near the end of the fiscal year.

### **Financial Statement Audit Issues**

We assessed the impact of our audit findings on the agency's financial statement reporting. We have concluded that, although a control weakness exists, it does not adversely impact the reliability of financial or performance reporting. We observed no instances of material non-compliance with laws or regulations.

We have also reviewed the status of recommendations for corrective action that resulted from prior audits of the agency's financial statements. The comprehensive recommendations presented in this report will replace those earlier recommendations when this report becomes final.

### **Impact of the Audit Findings on Financial Reporting**

The RRB is not an asset intensive agency. The potential monetary impact of the existing internal control weakness is very low relative to the financial statements when taken as a whole.

In its FY 1998 financial statements, the RRB reported an investment in physical assets, software and leasehold improvements exceeding \$30 million at historical cost. However, most of the recorded assets were fully depreciated and the value, net of depreciation, is only \$7.3 million. The agency reported total financing sources in excess of \$9 billion for the same period.

Although the financial statement audit process has, in the past, identified errors in recording, tracking and disposition of fixed assets, none had a material impact on financial reporting.

Accordingly, we have determined that the existing internal control weakness is not a reportable condition for financial statement audit purposes.

The formal definition of “reportable condition” and “material weakness,” as set forth by the Office of Management and Budget in Bulletin #98-08, “Audit Requirements for Federal Financial Statements,” is presented in full text in Appendix II.

### **Status of Prior Recommendations**

We have reviewed the status of agency actions to correct conditions related to fixed asset management identified during prior audits. These recommendations were made by independent public accountants and the OIG as a result of conditions identified during audits of the agency’s 1995 and 1997 financial statements.

The prior auditors observed that required physical verification reviews had not been performed and that asset dispositions were not recorded timely or accurately. As a result, they made recommendations for compliance with existing procedures and development of new internal controls.

Financial statement audits include only a limited scope review of internal control over fixed assets. As a result, the recommendations for corrective action were similarly limited. Those recommendations did not address the root causes of the identified problems. In addition, the Board has revised Administrative Circular BSS-2, the applicable agency guidance, since those findings were made.

Based on our full scope review, we believe that the conditions previously identified during financial statement audits were merely symptoms of an inefficient and ineffective process. The recommendations contained in this report address the entire system of internal control over fixed assets.

Accordingly, the outstanding prior audit recommendations will be closed and replaced by

the comprehensive recommendations of the current audit. The full text of the prior audit recommendations is presented in Appendix I.

**(Appendices available upon request)**